

**VERIZON WASHINGTON, DC INC.**  
**FORMAL CASE NO. 962**  
**RESPONSE TO OPC DATA REQUEST NO. 1**

September 5, 2001

- 1.1. "Not Using Verizon Operator" Scenario.  
In the calculation for "Total Direct Expenses" and "% Avoided," why is the Intrastate Amount (column G) \$0 for Accounts 6621/6622 – Call Completion/Number Svcs. and for Account 6220 – Operator Systems rather than including the Intrastate Amount and entirely avoiding the expense (as was done in the January filing)?

**RESPONSE:** Verizon DC generally objects to ~~requests~~ that ~~seek~~ information about the January 2001 filing. Without waiving the objection, the calculation in the July 16, 2001 filing is consistent with the Eighth Circuit's decision. The applicable standards to consider in determining the resale discount ~~are~~ (1) the costs that ~~are~~ actually avoided – not those that could *potentially* be avoided, and (2) that Verizon will continue to have retail customers. ~~These~~ have ~~been~~ considered in the July filing. Prior to the Supreme Court's decision the applicable **standard** was one of potentially avoidable costs assuming a 100% wholesale company.

in the current study, if the ~~reseller~~ opts not to use Verizon ~~Operators~~, then all of the costs, ~~expenses, revenues etc.~~ associated with operator services ~~are~~ not part of the equation. ~~This~~ is **analogous** to the situation with ~~interstate services~~, non-regulated services, and ~~so~~ on. The **goal is to** identify the avoided ~~costs associated~~ with the services that ~~are~~ to be ~~resold~~ and ~~to~~ develop a **relationship between** the avoided ~~costs~~ of ~~those~~ services and the **revenues** associated with those services.

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- 1-5. Itemize all revisions (mathematical and methodological changes) that were made between the January 29, 2001, resale discount study and the revised July 16, 2001, resale discount study and provide a detailed explanation for each revision.

**RESPONSE:** Verizon DC generally objects to all requests that seek information about the January 2001 filing. Without waiving the objection, the scenario in which Operator shortfall was included was changed. The workpaper detailing the development of the Operator shortfall was streamlined, eliminating material which did not impact the final result.

As a result of the Eighth Circuit's decision, only those indirect expenses that vary with the level of retail output are avoided. Previously all indirect expense categories were considered avoidable based on a percentage avoidance of direct expense categories. The testimony filed on July 16, 2001 provides a more detailed explanation.

Operator Services was treated in the January 29, 2001 filing as avoidable when the reseller opts not to use Verizon DC's operators. Further, as a result of the Eighth Circuit's decision, Operator Services in the July 16, 2001 filing, are treated as services that are not being resold rather than as being avoided. Previously they were treated as avoidable when the reseller opts not to use Verizon D.C. operators.

All Function codes were examined from the perspective of an "avoided" rather than

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**“avoidable” standard in the July 16, 2001 filing.**

**All Function codes were examined based on the Company continuing to offer services on a retail basis and not solely as a 100% wholesale provider.**

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**September 20, 2001**

- 1-13. Explain why the indirect cost account. "General & Administrative" (Account 6728) is only 16.66% and 17.32% avoided in the wholesale market.

**RESPONSE:** Based on the revised methodology, only those costs in Account 6728 that are actually avoided when a reseller provides the service to the end user versus Verizon are considered. Namely, general and administrative costs directly associated with "avoided" personnel, such as sickness and disability payments, are considered avoided. Other costs in this account are not considered avoided in determining the resale discount.

**FOLLOW-UP REQUEST:**

Please provide the study and identify step-by-step how the avoided percents were determined for each subaccount in "General & Administrative" (Account 6728)

**RESPONSE** The study was provided in Verizon DC Exhibit C, specifically, on CD #2 in the folder marked "RETAIL DISCOUNT STUDY." See Tab 6 - Avoided Cost by FC. lines 882 through 985. An explanation of how the avoided indirect percents were calculated is provided on pages 233 and 234 of Verizon DC Exhibit D.

**VERIZON WASHINGTON, DC INC.****FORMAL CASE NO. 962****RESPONSE TO OPC DATA REQUEST NO. 1**September **5,2001**

1-36. What does "Utilization, Equipment **Common**" represent? What is the **basis**?

**RESPONSE:** Digital Loop Carrier equipment (DLC) has **an** initial material & labor investment for shelves, ~~power~~ equipment, monitoring equipment, and transmission circuit cards ("plug-ins"). **This** investment is **called** "Hardware & **Common** Equipment", or "Equipment, **Common**" in the LCAM studies. The value **used** is the jurisdiction average of the feeder fill factor, because the DLC pairs **function as feeder** and **are** included in the **feeder** till calculation.

**VERIZON WASHINGTON, DC INC.**

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**SUPPLEMENTAL RESPONSE TO OPC DATA REQUEST NO. 1**

**September 12, 2001**

- 1-20. "The fiber strand utilization factor is developed based on actual data such as that reported on the ARMS 43-08 report." (Verizon DC Exhibit C-1 – Recurring, Non-Recurring, and OSS Cost Studies, p. 38). Why doesn't the cost study utilize a forward-looking factor for fiber strand utilization (as it does other factors such as the RT channel unit and copper feeder utilization)?

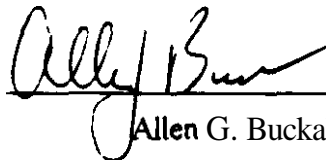
**RESPONSE:** Verizon DC will provide a response to this request on September 12, 2001.

Fiber cable has been deployed for **many** years in Verizon's operation and the utilization rate has been stable. There is nothing in the forward looking technology model or **in** the demand characteristics that drive fiber utilization that suggest a significant change, up **or** down, **in** this utilization rate in the future. Therefore in the judgement of Verizon's engineering experts, the current actual utilization was used as the best available estimate of the forward looking utilization.


**AFFIDAVIT**

STATE OF VIRGINIA            )  
  ) ss  
COUNTY OF ARLINGTON    )

Allen G. Buckalew, being first duly sworn, on oath deposes and says that he has read his foregoing direct testimony on behalf of the Office of the People's Counsel of the District of Columbia identified as OPC Exhibit (A) in Formal Case No. 962 before the Public Service Commission of the District of Columbia; that if asked the questions therein his answers in response would be as shown; and that the facts contained in the answers are true and correct to the best of his knowledge, information and belief

  
Allen G. Buckalew

Subscribed and sworn to before me, the undersigned notary public, this 9<sup>th</sup> day of October, 2001

  
Notary Public

My Commission Expires: November 30, 2004



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**COMMUNICATION COMPANIES THAT HAVE WITHDRAWN OR ABANDONED  
SERVICE APPLICATION IN THE DISTRICT OF COLUMBIA**

<b>Company Name</b>	<b>PSC Order No.</b>	<b>Order Date</b>
Eagle Communications, Inc.	12620	December 16, 2002
Adelphia Business Solutions Operations, Inc.	12607	November 25, 2002
American Communication Services of D.C. (d/b/a e.spire)	12583	October 23, 2002
Teleseon Carrier Services	12559	October 2, 2002
OneStar Long Distance, Inc.	12544	August 23, 2002
Vitts Networks, Inc.	12099	August 16, 2002
2 <sup>nd</sup> Century Communications, Inc.	12100	August 16, 2001
Urban Media of the District of Columbia, Inc.	12093	August 9, 2001
Integrity Telecontent Services, Inc.	12049	July 2, 2001
Prim Operations, Inc.	12027	June 8, 2001
United States Telecommunications, Inc. (d/b/a Tel Coni Plus)	12404	May 15, 2002
Verizon Advanced Data, Inc.	12268	December 14, 2001
Network Plus, Inc.	12556	September 26, 2002
Telergy Network Services, Inc.	12555	September 23, 2002
MegsINET-CLEC, Inc.	12070	July 25, 2001
Northpoint Communications, Inc.	12012	May 21, 2001
Picus Communications, LLC	12007	May 18, 2001

Conectiv Communications, Inc.	11996	May 10,2001
Global NAPs South, Inc.	11929	March 30,2001
HD Marketing, LLC	11954	March 22,2001
Dynamic Telco Services, Inc.	11917	February 13,2001
Digital Broadband Communications	11903	February 1,2001
PetroNet Operating Corporations	11904	February 1,2001

All applications are in Formal Case No. 892 before the D.C. Commission

## DIRECT TESTIMONY OF

**ALLEN G. BUCKALEW**

## **I. QUALIFICATIONS AND INTRODUCTION**

**Q. Please state your name, occupation and business address.**

A. My name is Allen G. Buckalew. I am an Economist specializing in the telecommunications industry at J.W. Wilson & Associates, Inc. Our offices are at 1601 North Kent Street, Rosslyn Plaza C – Suite 1104, Arlington, VA 22209.

**Q. Please outline your educational background.**

A. I hold an A.A. and a B.S. degree with high honors, both from the University of Florida, and a M.S. degree from George Washington University. My major areas of concentration were economics and telecommunications.

**Q. How have you been employed in the past?**

A. Before I entered the University of Florida, I worked for four years in Naval Telecommunications. After graduating from the University of Florida, I worked for four years at the Federal Communications Commission ("FCC") as an Industry Economist in the Common Carrier Bureau and was employed extensively in areas involving telecommunications, economics, accounting, engineering, and policy matters. For example, one of my major projects was "The Economic Implications

1 and Interrelationships Arising from Policies and Practices Relating to Customer  
2 Interconnection, Jurisdictional Separations and Rate Structures,” (Docket No.  
3 20003). This case opened the terminal equipment (*e.g.*, telephone sets, and private  
4 branch exchanges (“PBXs”)) market in the United States to competition. I also  
5 provided economic analysis in several rate cases. For example, “Communications  
6 Satellite Corporation, Investigation into Charges, Practices, Classifications, Rates  
7 and Regulations,” (Docket No. 16070). My major responsibility was to serve as  
8 economic advisor and analyst for the Common Carrier Bureau.

9 After the FCC, I was appointed Associate Director for Telecommunications  
10 Research of the National Regulatory Research Institute (“NRRI” or “Institute”) at  
11 Ohio State University. My responsibilities at NRRI focused on  
12 telecommunications policy as seen from an analytical perspective that combined  
13 accounting, engineering, and economic disciplines. During my employment at the  
14 Institute, I completed several studies for state public utility commissions,  
15 including “The Impact of Measured Telephone Rates on Telephone Usage of  
16 Government and Nonprofit Organizations” (for the Public Utilities Commission of  
17 Ohio) and “Toward An Analysis of Telephone License Contracts and Measured  
18 Rates” (for the Maryland Public Service Commission).

19 In addition, I have provided several state Commissions with technical and  
20 economic assistance. This assistance was related to identifying, explaining and  
21 analyzing major issues in telecommunications cases. Since joining J.W. Wilson &

1 Associates, Inc. in May 1980, I have provided economic analysis in numerous  
2 proceedings in most of the states of the United States, Canada, Bolivia, Nepal,  
3 Egypt, and Tanzania. I have provided analysis for the Federal Communications  
4 Commission and the United States Department of Justice. For example, I testified  
5 on behalf of the Department of Justice in the case that broke up the Bell system.  
6 In addition, I have worked for numerous State Attorneys General. For example, I  
7 evaluated the merger proposal of Bell Atlantic and NYNEX for the National  
8 Association of Attorneys General, and the Bell Atlantic and GTE merger proposal  
9 for the Pennsylvania Attorney General. I also analyzed the merger proposal of  
10 MCI and WorldCom for the California Public Utilities Commission.

11 **Q. Are you a member of any professional organizations and honor societies?**

12 A. Yes. I am a member of the Society of Depreciation Professionals, the American  
13 Economic Association, Omicron Delta Epsilon (an international honor society in  
14 economics) and Beta Gamma Sigma (an honor society in business).

15 **Q. Could you briefly summarize your professional responsibilities to date?**

16 A. Yes. My primary responsibilities have been to supervise and actively participate  
17 in public utility regulatory policy research, especially in the telecommunications  
18 field. These responsibilities require the use and application of economic,  
19 accounting, and engineering analyses.

1    **Q.    On whose behalf are you testifying?**

2    A.    I present this testimony on behalf of the Office of the People's Counsel ("OPC" or  
3           "Office) of the District of Columbia.

4    **Q.    What is the purpose of your testimony?**

5    A.    I have been asked by the OPC to analyze the cost studies and proposed rates  
6           presented by Verizon DC Washington, DC, Inc. ("Verizon DC" or "Company") in  
7           this case. I have focused on the cost of unbundled loops and Verizon DC's  
8           wholesale discount rate for resold services.

9    **Q.    How are you going to address this task?**

10   A.    I am going to start by presenting my review of the Wholesale Discount Study and  
11          Verizon DC's proposed resale discount rates. I will then present my review of  
12          the cost studies for unbundled network elements. Finally, I will address the cost  
13          of the high frequency portion of the loop in line sharing, and why I disagree with  
14          Verizon DC's cost allocation for the voice portion of the loop and the high  
15          frequency use of the same loop.

1 **Summary of Conclusions and Recommendations**

2 **Q. What is the purpose of this proceeding and why is it important to D.C.**  
3 **ratepayers?**

4 **A. The Commission opened this proceeding in order to investigate the availability**  
5 **and rates of telecommunications services in the District of Columbia for Certified**  
6 **Local Exchange Carriers ("CLECs"). This proceeding is intended to determine**  
7 **the cost and availability of Unbundled Network Elements ("UNEs") and the**  
8 **establishment of a Wholesale Discount Rate.**

9 **The Telecommunications Act of 1996 was designed to make entry into the**  
10 **Telecommunications market easier. The Act specified three means for entering**  
11 **the local telephone service markets. One method is to resell the services of**  
12 **incumbent local exchange carriers ("ILECs") through purchasing services at**  
13 **wholesale rates, and reselling the services at a marked-up price. Another approach**  
14 **is to purchase Unbundled Network Elements from ILECs. This approach enables**  
15 **CLECs to combine its own facilities with that of the local telephone company's in**  
16 **order to provide local exchange service. The third method for entering the market**  
17 **is to build a new network.**

18 **Through this proceeding the Commission will determine the wholesale discount**  
19 **rate that CLECs will receive when purchasing wholesale telecommunication**  
20 **services from Verizon DC. The outcome of this proceeding will also determine**

1 the rates for UNEs. Most CLECs that enter the telecom market do so by either  
2 purchasing services at wholesale, or by leasing UNEs. Therefore, in order for the  
3 telecom market to develop and flourish in the District of Columbia, both the  
4 wholesale discount rate and the price of UNEs must be established at accurate and  
5 forward-looking rates.

6 **Q. Please summarize your principal conclusions and recommendations.**

7 **A.** I conclude that Verizon DC's wholesale discount study does not fully analyze  
8 avoided costs and does not comply with any known FCC rules. Therefore, until  
9 the FCC develops new rules, I recommend that the Commission disregard Verizon  
10 DC's suggested wholesale discount rate and continue using the interim discount  
11 rate of 24.7%.

12 I further conclude:

- 13 • The Wholesale discounts proposed by Verizon DC are unreasonable  
14 because they do not consider all the costs that will actually be avoided in  
15 the long run.
- 16 • Verizon DC's method for calculating Wholesale Discounts does not  
17 comply with any known Federal Communications Commission ("FCC")  
18 rule and does not determine avoided costs.
- 19 • If Verizon DC's proposed discounts are adopted, competition will probably  
20 not occur because competitive local exchange carriers ("CLECs") will not  
21 be able to make a profit at the proposed wholesale discount rates.
- 22 • OPC recommends that the new wholesale discount rate should remain at  
23 the interim rate of 24.7%, until new rules are adopted by the FCC.
- 24 • Technical and market trials that are being tested in the retail market for less  
25 than 90 days should not be subject to resale obligations; trials longer than



1 90 days should be subject to the wholesale rate obligation and offered to  
2 CLECs in the resale market.

3 I also conclude that Verizon DC method used to calculate UNE costs is  
4 reasonable. However, I recommend a few changes in the recurring cost analysis  
5 that are needed to make the results reflect forward looking costs. I recommend  
6 changing the Fill Factors used by Verizon DC in the LCAM model. The Fill  
7 Factors I recommend be input in the LCAM model are an attempt to estimate  
8 forward-looking utilization, rather than the current utilization used by Verizon DC.  
9 Specifically,

- 10 • The cost models for setting permanent rates for Unbundled Network  
11 Elements should consist of economically correct cost studies that reflect  
12 current network facilities, in a forward-looking environment.

13 In addition, I recommend that the cost of the loop be shared by voice and data  
14 services, rather than the approach used by Verizon DC that assigns all the costs to  
15 voice services. I recommend that these costs be shared equally: 50% to voice and  
16 50% to data.

17 Specifically,

- 18 • All services using the loop (e.g., voiceband service, data-based service)  
19 should share in the cost of the loop.
- 20 • A just and reasonable allocation of costs in line sharing is to equally  
21 allocate the costs between data usage and voice usage.

22 **Q. What is the overall effect if OPC's positions are adopted?**

23 **A.** If OPC's position is adopted with regard to the wholesale discount study, the  
24 Commission will disregard Verizon DC's suggested wholesale discount and  
25 continue using the interim discount rate of 24.7%. OPC has suggested that the

1 Commission adopt our suggestions because the Wholesale Discount study that  
2 Verizon DC filed is flawed and does not produce accurate wholesale discount  
3 rates. OPC recommends continuing the use of the 24.7% interim wholesale  
4 discount rate until the FCC develops new rules for determining avoided costs for  
5 the sale of resold telecommunications services.

6 With regard to Verizon DC's UNE costs, OPC recommends changing the Fill  
7 Factors used by Verizon DC in the LCAM model. The fill factors that OPC  
8 suggests represent forward-looking utilization in the Telco's network, and  
9 therefore reflect the cost of unbundled loops in the future. If the Commission  
10 adopts the fill factors suggested by OPC, the resulting price of unbundled loops  
11 would be lower than the prices proposed by Verizon DC.

12 Finally, OPC recommends that the cost of the loop be shared by voice and data  
13 services, rather than just voice services, as Verizon DC proposed. Using OPC's  
14 approach, 50% of the cost of the loop would be assigned to voice services and the  
15 other 50% of loop costs would be assigned to data services.

16 **Q. What issues will you address in your testimony?**

17 **A. I will address the following issues:**

18 **Issue 3: proper allocation of methodology for determining the wholesale discount**  
19 **rate.**

1       **Issue 5: appropriate treatment for taxes in calculation of the wholesale discount**  
2       **rate.**

3       **Issue 6: appropriate wholesale discount rate for resale for Verizon DC's retail**  
4       **services?**

5       **Issue 7: should Verizon DC be required to offer its individual customer contracts**  
6       **for resale at the wholesale discount?**

7       **Issue 9: should Verizon DC be required to make its technical and market trials**  
8       **available for resale, and, if so, should the wholesale discount rate apply?**

9       **Issue 12: what cost studies should serve as the basis for setting permanent rates,**  
10       **and why?**

11       **Issue 13: what inputs should be used?**

12       **Issue 13.2: what fill factors do you recommend and why should your**  
13       **recommendation be considered?**

14       **Issue 14.1: what rate do you believe the Commission should approve for**  
15       **unbundled loops and why?**

16       **Issue 16: should the Commission require Verizon DC to provide unbundled**  
17       **copper loops compatible with ISDN and xDSL with conditioning or additional**  
18       **electronics priced separately?**

1 Issue 16.6: should the Commission require Verizon DC charge no more to CLECs  
2 for access to shared local loops than the amount of loop costs Verizon DC  
3 allocated to xDSL services when Verizon DC established its interstate retail rates  
4 for these services? If so, why? If not, why not?

## 5 **II. Wholesale discount**

6 **Q. What is the Wholesale discount rate?**

7 A. Section 251(c)(4) of the Telecommunications Act of 1996 ("Act") required incumbent  
8 Local Exchange Carriers ("ILECs") to offer at "wholesale rates" any  
9 telecommunications services that ILECs provide at retail to subscribers who are not  
10 telecommunications carriers.<sup>1</sup> Specifically, section 252(d)(3) of the Act stated that  
11 wholesale rates shall be set "on the basis of retail rates charged to subscribers for the  
12 telecommunications service requested, excluding the portion thereof attributable to  
13 any marketing, billing, collection, and other costs that will be avoided by the local  
14 exchange carrier."<sup>2</sup>

15 The Wholesale Discount Rate represents the avoided costs that will not be incurred by  
16 ILECs when selling telecommunications services to certified local exchange carriers  
17 ("CLECs") in the wholesale environment. Therefore, the cost of purchasing  
18 wholesale services is equal to the retail rate charged to subscribers for the particular  
19 service, less the wholesale discount rate.

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<sup>1</sup> 47 USC § 251(c)(4) (1996), as amended.

<sup>2</sup> 47 USC § 251(d)(3) (1996), as amended.

1 **Q. Why is it important to Verizon DC customers that the Commission establish**  
2 **accurate Wholesale discount rates?**

3 **A. Wholesale discount rates directly impact the level of competition in the**  
4 **Washington, DC telecommunications market. Accurate wholesale discount rates**  
5 **are a prerequisite to the establishment of effective competition. Resale is an**  
6 **important initial strategy for many new entrants who may lack capital to compete**  
7 **in the local exchange market by purchasing unbundled elements or by building**  
8 **their own networks. In light of the strategic importance of resale to the**  
9 **development of competition, the discount rates established must reflect the actual**  
10 **and expected avoidable costs of wholesale services.**

11 **Q. What is the proper application of the methodology for determining the**  
12 **wholesale discount rate (Commission Issue 3)?**

13 **A. The wholesale discount rate should be determined using company specific**  
14 **intrastate cost accounts, and deducting all costs that will be avoided when services**  
15 **are sold at wholesale rather than retail. The calculation of the discount rate should**  
16 **incorporate both direct and indirect costs. Direct costs that will be avoided should**  
17 **be calculated first, and then the ratio of direct avoided intrastate costs to total**  
18 **direct intrastate costs should be applied to each of the indirect cost accounts to**  
19 **determine the level of avoided intrastate indirect expenses. Finally, the total direct**  
20 **and indirect avoided expenses should be added together and divided by total**

1 intrastate revenues. The resulting percentage represents the value of the resale  
2 discount.

3 The FCC issued its First Report and Order on August 8, 1996.<sup>3</sup> This Order  
4 established pricing rules for calculating Wholesale Discount rates and was a  
5 reasonable approximation of avoided costs. Among the issues in that Order, the  
6 FCC determined proxy interim discount rates, categorized Direct Cost Accounts,  
7 Indirect Cost Accounts and specified the appropriate method for avoiding costs  
8 within each account. On July 18, 1997, in *Iowa Utilities Board v. FCC*, the United  
9 States Court of Appeals for the Eighth Circuit ("Eighth Circuit") vacated portions  
10 of the Commission's rules and remanded them back to the FCC subject to further  
11 review.<sup>4</sup> At this time the FCC has adopted no rules for determining the wholesale  
12 discount. Therefore, there are currently no FCC pricing standards for determining  
13 wholesale discount rates for resold services.

14 **Q. How did Verizon DC determine the avoided costs used to calculate the resale**  
15 **discount rate?**

16 **A. Verizon DC states that its approach is based on the language in the Eighth**  
17 **Circuit's remand order. Verizon DC's focus is to determine costs that it claims are**  
18 **actually avoided. Verizon DC calls the methodology used in calculating the resale**

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<sup>3</sup> In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket No. 95-185, FCC Docket No. 96-325, ("First Report and Order") (rel. Aug. 8, 1996).

<sup>4</sup> Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8<sup>th</sup> Cir. 1997).

1 discount rate a functional approach in which total company expenses, using  
2 account function codes, are adjusted using Part 64 regulated factors and intrastate  
3 separation factors in order to identify the corresponding intrastate expenses.  
4 Operator service expenses are removed from intrastate expenses if the reseller opts  
5 not to use Verizon DC's services.

6 **Q. Do you agree with Verizon DC's methodology for calculating a resale**  
7 **discount?**

8 **A.** No. Verizon DC's method is little more than a guess at which costs will actually  
9 be avoided because it has very few competitive local exchange carriers as  
10 customers and thus very few avoided costs. Resold lines only make up  
11 [proprietary information] of Verizon DC's total number of access lines.<sup>5</sup>

12 **Q. Could you please explain why you think Verizon DC has not properly**  
13 **calculated avoided expenses**

14 **A.** In its calculation of avoided expenses, Verizon DC has made the following errors:

- 15 • Call Completion/Number Services and operator systems have  
16 been mistreated in the calculation of the resale discount for "not  
17 using Verizon DC's operators."
- 18 • Direct expenses have been overstated for accounts 6611, 6613,  
19 6623, 6533, 6110, 6310 and 6510.
- 20 • The calculation of avoided indirect costs is understated and  
21 incomplete.

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<sup>5</sup> See. Verizon DC Data Response to OPC Data Request No. 1, Question 1-14, (OPC Exhibit A-1).

- Verizon DC's method for calculating avoided costs has not been approved by the FCC. (The FCC rules in the First Report and Order have been vacated by the Eighth Circuit Court, and the Court has remanded the rules back to the FCC. No new FCC rules have been established as of this date).

**Q. How has Verizon DC calculated avoided expenses for call completion/number services and operator systems?**

**A. As Verizon DC states in its panel testimony, "These expenses are removed since they are not associated with services that are being resold and are entirely avoided, if the reseller is using its own operator services platform." (See, Verizon DC Exhibit D at 219, lines 17-19) (Emphasis added). The reseller has two options in the wholesale environment: 1) to use Verizon DC's operator services, or 2) not to use Verizon DC's operator services. Consequently, these expenses should be 100% included in the calculation of the intrastate expenses when the reseller opts to use Verizon DC's operator services, and 100% avoided (but not removed) when CLECs opt not to use Verizon DC's operators.**

**Verizon DC explained in response to OPC Data Request 1, Question 1-5 that "Operator Services was treated in the January 29, 2001 cost study as avoidable when a reseller opts not to use Verizon DC's operators.<sup>6</sup> Further, as a result of the Eighth Circuit's decision, Operator Services in the July 16, 2001 cost study are treated as services that are not being resold rather than being avoided."<sup>7</sup>**

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<sup>6</sup> Verizon DC Data Response to OPC Data Request No. 1, Question 1-1. (OPC Exhibit A-2).  
<sup>7</sup> Verizon DC Data Response to OPC Data Request 1, Question 1-5. (OPC Exhibit A-3).



1    **Q.    Why is Verizon DC's method for avoiding call completion/number services**  
2       **and operator systems incorrect?**

3    A.    The treatment of operator services in the July 2001 cost study is incorrect because  
4       operator services are being offered as a resold service, therefore, they should be  
5       included in the calculation of avoided expenses accordingly.

6       The effect of removing call completion/number services and operator systems  
7       from the calculation of avoided expenses, rather than including those intrastate  
8       expenses and then counting them as "avoided" costs, mathematically reduces the  
9       effective discount rate in the "Not Using Verizon DC Operators" scenario.

10       Verizon DC reports it examined all function codes from the perspective of an  
11       "avoided" rather than "avoidable" standard in the July 16, 2001 filing.<sup>8</sup> If this is  
12       the case, Verizon DC should calculate the avoided amount for call  
13       completion/number services and operator systems as 100% "avoided" when a  
14       CLEC does not use these services, rather than completely removing the accounts  
15       from the calculation.

16   **Q.    What do you mean "mathematically reduces the effective discount rate?"**

17   A.    In Verizon DC's Resale Discount Study, "Not Using Verizon DC Operators"  
18       scenario, the proposed resale discount is [proprietary information]. Using Verizon  
19       DC's exact Resale Discount Study with the following modifications:

- “Intrastate Amount” is included in column G for both Call Completion/Number Services and operator systems accounts.
- 100% of intrastate expenses are avoided for those accounts in columns H and I, and
- Resale Discount uses revenues from the “Using Verizon DC Operators” scenario in the denominator to calculate the resale discount.

The resulting resale discount would be [proprietary information]. The effect of removing these accounts from the study can clearly be seen. Verizon DC has no basis for removing the intrastate expenses from the calculation for the resale discount, other than to depress the resulting discount rate

**Q. How should expenses associated with call completion/number services and operators systems be treated?**

**A.** As I mentioned above, these expenses are 100% avoided when the reseller opts not to use Verizon DC’s operations. Therefore, they should be avoided 100%, rather than removed from the study.

**Q. Do you have other issues you want to raise regarding Verizon DC’s calculation of direct avoided costs?**

**A.** Yes, I do. I believe that the avoided costs for many of the accounts do not appear to have been thoroughly examined, and are therefore understated.

1 **Q. Could you please elaborate on how the Company has underestimated avoided**  
2 **costs from direct expenses?**

3 A. Marketing expenses such as product management (Account 6611) and product  
4 advertising (Account 6613) should be avoided at 100%, in the same way that Sales  
5 (Account 6612) is avoided. These two accounts are related to the marketing of  
6 products and services with the intent of selling products and services directly to  
7 retail customers. The Company's decisions regarding marketing will be directly  
8 tailored to maximize Verizon DC's retail sales, not to promote the reseller's  
9 products and services. Advertising will be targeted to the Company's products,  
10 and in a competitive environment this advertising is intended to lure customers to  
11 remain or become loyal Verizon DC customers.

12 The Company states "resellers benefit from Verizon DC's product advertising –  
13 end users will be stimulated to purchase more products not just from Verizon DC,  
14 but from the resellers."<sup>9</sup> On the contrary, resellers are responsible for preparing  
15 their own advertising and marketing plans in order to increase/retain the resellers'  
16 customer base.

17 **Q. Do you agree with the Company's treatment of Account 6623, Customer**  
18 **Services?**

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<sup>9</sup> Verizon DC Exhibit D at 225, lines 19-21.

1 A. No. Nearly all expenses in this account should be avoided because a majority of  
2 costs in this account are incurred from establishing and servicing customer  
3 accounts.<sup>10</sup> Moreover, I disagree with the Company that subaccounts such as  
4 Carrier Access and Cellular Customer Billing and all ICSC (Interexchange Carrier  
5 Service Center) are not avoided. The Company states, these services "are not  
6 subject to resale."<sup>11</sup> Therefore, these costs should be included as an avoided  
7 expense, as they are not related to a wholesale environment of local service.

8 Also, functions such as: Annoyance Call Bureau, and Message Investigation will  
9 be the responsibility of the reseller. Hence, some of these expenses should be  
10 avoided. Expenses associated with functions related to collecting and reporting  
11 pay stations (public telephone station) receipts should also be avoided.

12 **Q. Do you have any comment on Verizon DC's treatment of Account 6533 -**  
13 **Testing?**

14 A. I believe that a higher percentage of the expenses in Account 6533 should be  
15 avoided for products and services at wholesale. For example, testing expenses  
16 associated with special services should be avoided because they are not related to  
17 local service products.

18 **Q. Do you have any other comment on Verizon DC's direct avoided expenses?**

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<sup>10</sup> C.F.R Telecommunications, 47 CFR § 32.6623 (1999).

<sup>11</sup> Verizon DC Exhibit D at 227, line 25.

1 A. Yes, I do. Verizon DC did not avoid any of the intrastate expenses associated with  
2 several accounts, such as: Account 6110 (network support), Account 6310  
3 (information origination/termination), and Account 6510 (other property, plant and  
4 equipment). These accounts contain expenses that are unrelated to the resale of  
5 local services, or expenses that will decrease as the ILEC sells its services at  
6 wholesale as a result of downscaling operations. Consequently, a percentage of  
7 these expenses should be included in the resale avoided discount. For example,  
8 aircraft expenses should be 100% avoided, as they are not directly attributable to  
9 retail local service or resale.

10 There are other mistakes made by Verizon DC. For example, the Company takes  
11 the Uniform System of Accounts ("USOA") data and attempts to remove several  
12 services. The end result is that it removes services accounting for about 40% of  
13 expenses but only about 25% of the revenues, thereby reducing the avoided  
14 discount. The total company intrastate revenue to expense ratio is 1.5%. After  
15 Verizon DC has removed services for its wholesale discount study, the total  
16 intrastate revenue to expense ratio subject to resale escalates to 1.9%. The  
17 resulting effect on the avoided discount rate is a lower discount. For example:

18 **PROPRIETARY**

19  
20  
21 **Verizon DC's Calculation of the Direct Discount**  
22 **Rate Using Verizon DC's Operators**

**Calculation of Direct Discount Rate**  
**if Revenues Were Avoided Near**  
**Same Level of Avoided Expenses**

23  
24 **Avoided Direct Expense \$ [proprietary information]**

1       Uncollectibles   \$ [proprietary information]

2       Revenues       \$[proprietary information]       \$[proprietary information]

3       Direct Discount Rate [proprietary information] [proprietary information]

4       Furthermore, in Verizon DC's attempt to remove services from the USOA data,  
5       some services were inconsistently and incorrectly adjusted. For example, Verizon  
6       DC states that "Carrier Access and Cellular Access are not subject to resale," thus  
7       "these expenses are not avoided."<sup>12</sup> If these services are not subject to resale 1)  
8       the expenses associated with these accounts should be avoided 100%, or 2) the  
9       expenses should be removed from the intrastate expenses that are subject to resale  
10      in the cost study.

11      On the contrary, Verizon DC included [proprietary information] of Intrastate  
12      expenses from these two accounts in the wholesale discount calculation, and  
13      avoided 0% of those expenses. The end result is that the avoided discount rate is  
14      lower than if Verizon DC had removed these expenses in the wholesale discount  
15      calculation (as it did with Operator Services), or avoided them at 100%, as they  
16      should have since they are "not subject to resale."

17      Additionally, Verizon DC has no real support for some of its assumptions. For  
18      example, with respect to Uncollectibles it states that it does not have actual  
19      avoided data and uses the overall weighted average of Uncollectibles associated  
20      with end user revenues in those jurisdictions where retail and wholesale

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<sup>12</sup> Verizon DC Exhibit D at 227-228.

1       Uncollectibles have started to be tracked separately. This was used because it is  
2       “Verizon DC’s best estimate of the level of Uncollectibles to be experienced in the  
3       future.”<sup>13</sup>

4       This approach to avoiding expenses is not consistent with the methodology  
5       Verizon DC claims it used to calculate the wholesale discount rate. Verizon DC  
6       maintains that it has used the Eighth Circuit’s methodology, which states:

7               “Wholesale rates shall exclude ‘costs that will be avoided by the  
8               local exchange carrier.’...The plain meaning of the statute is that  
9               costs that are actually avoided, not those that could be or might be  
10              avoided, should be excluded from the wholesale rates” (Iowa Utils.  
11              Bd. v. FCC, 219 F.3d at 755). Therefore, Verizon DC’s “best  
12              estimate” of the level of Uncollectibles in the future is unsupported  
13              and not valid under its own interpretation of calculating wholesale  
14              discount rates. Verizon is simply picking and choosing  
15              methodologies in order to produce its desired outcome.

16   **Q.     Have you reviewed Verizon DC’s analysis of indirect avoided costs?**

17   **A.     Yes, I have. Verizon DC explains that avoided indirect expenses are those**  
18       **functions that support avoided direct expense functions. All functions reflected in**  
19       **General Support (Accounts 612X) and General Overhead or Corporate Operations**  
20       **(Accounts 67XX) are not considered direct expenses, yet all are activities of the**  
21       **telephone company. The Company has failed to include in the avoided amount**  
22       **several expense accounts that definitely support activities related to its retail**  
23       **business that do not support wholesale activities. Furthermore, many of these**

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<sup>13</sup> Verizon DC Exhibit D at 232, lines 8-9.

1 expenses will vary as the Company changes its production scale; expenses will be  
2 reduced when products and services are sold at wholesale, instead of at the retail  
3 level. The Company recognized this fact in its response to OPC Data Request No.  
4 1, Question 1-5, "[a]s a result of the Eighth Circuit's decision, only those indirect  
5 expenses that vary with the level of retail output are avoided."<sup>14</sup> These expenses  
6 are caused by activities related to local services and, therefore, they will be  
7 partially avoided for those services that are actually for resale. For example,  
8 Verizon DC claims, "the expense of information system and programming and  
9 maintenance (Account 6724 – Information Management) does not vary based on  
10 the level or existence of retail output, and therefore, is not avoided."<sup>15</sup> However,  
11 Verizon DC identifies Account 6124 (General Purpose Computers) as having  
12 avoided expenses.<sup>16</sup> By definition, Account 6724 includes:

13 "costs incurred in planning and maintaining data bases and  
14 application systems for general purpose computers."<sup>17</sup>

15 For that reason, expenses in Account 6724 should be avoided in the same  
16 proportion as Account 6124 is avoided.

17 **Q. Are there any other indirect costs for which you believe Verizon DC has**  
18 **underestimated the avoided percentage?**

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<sup>14</sup> Verizon Data Response to OPC Data Request No. 1, Question 1-5. (OPC Exhibit A-3).  
<sup>15</sup> Verizon DC Exhibit D at 233, lines 9-12.  
<sup>16</sup> Verizon DC Exhibit D at 234, lines 7-8.  
<sup>17</sup> C.F.R. Telecommunications, 47 CFR §§ 32.6623, 32.6724 (1999).



1 A. Yes. I believe that Accounts 6722, 6727 and 6728 have been mistreated in the  
2 avoided cost calculation. Account 6722 (External Relations) and Account 6727  
3 (Research and Development) should be avoided for wholesale activities. A  
4 considerable portion of Account 6722 (External Affairs) is related to corporate  
5 image, corporate advertising, community relations, information for regulatory  
6 purposes, etc. These functions are related directly to retail in that they make up  
7 more than half of the total account expenses. They are not attributable to services  
8 for wholesale, thus they should be avoided. Additionally, even though Account  
9 6727 (Research and Development) pertains to new products, this activity is  
10 intended for the promotion of Verizon DC's retail business. It should be avoided  
11 almost entirely.

12 Another example of underestimation of indirect avoided costs is Account 6728  
13 (General and Administrative). In response to OPC Data Request No. 1, Question  
14 1-13, Verizon DC states:

15 "only those costs in Account 6728 that are actually avoided  
16 when a reseller provides the service to the end user versus  
17 Verizon DC are considered. Namely, general and  
18 administrative costs directly associated with "avoided"  
19 personnel, such as sickness and disability payments, are  
20 considered avoided. Other costs in this account are not  
21 considered avoided in determining the resale discount."<sup>18</sup>

1        Avoided expenses for this account should have been calculated based on the  
2        relation of avoided direct expenses to total direct expenses because directly  
3        avoidable expenses are embedded within this account.

4        **Q.    What is the appropriate treatment for taxes in the calculation of the**  
5        **wholesale discount (Commission Issue 5)?**

6        **A.    A portion of taxes should be avoided at wholesale. Taxes will be incurred**  
7        **regardless of who provides the service to the end user, however, a resale discount**  
8        **is calculated based on the current level of expenses and its impact on current**  
9        **revenues. Therefore, taxes will vary as net revenues change if there are changes in**  
10       **expenses associated with the Company's activities. By following the example**  
11       **presented on page 235 of Verizon DC Exhibit D, one can infer the following: an**  
12       **end user's service provides \$100 in revenues with \$80 in associated expenses, per**  
13       **month.<sup>19</sup> A net income of \$20 per month represents taxes of \$7 per month (at 35%**  
14       **rate). If the resale discount is 10%, revenues to Verizon DC will be \$90.**  
15       **Associated expenses have been calculated to be 10% avoidable, so they will**  
16       **decrease from \$80 to \$72, resulting in net income of \$18. The tax obligation now**  
17       **has changed from \$7 per month to \$6.3 per month. This is a definite impact on**  
18       **expenses due to resale of products and services that should be considered in**  
19       **calculating the resale discount.**

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<sup>19</sup>        See, Verizon DC Exhibit D at 235, lines 2-18.

1   **Q.   Has Verizon DC properly calculated the avoided percentage of uncollectibles**  
2       **for resale discount?**

3   **A.   No.** It is true, as Verizon DC states, that the cost of uncollectibles has nothing to  
4       do with the level of expenses, avoided or not.<sup>20</sup> Uncollectibles are a cost of  
5       providing service and would vary with the level of sales, whether they are at the  
6       wholesale or retail level. Nevertheless, the risk associated with the type of  
7       customers should also be considered. At wholesale, this risk is much smaller than  
8       the risk associated with end user customers. Resellers will assume complete  
9       responsibility of payment of the services its end-user customers received. Thus,  
10      the avoided percentage on the level of uncollectibles from resale should be nearly  
11      100%.

12   **Q.   Do you have any other concerns about Verizon DC's calculation of indirect**  
13       **costs?**

14   **A.   Yes.** Indirect Expenses are a result of activities that support direct expenses.  
15       Verizon DC has failed to avoid all but three indirect expense accounts. They are:  
16       1) General Purpose Computers (Account 6124), 2) Executive (Account 6711) and  
17       3) General & Administrative (Account 6728). In previous filings, Verizon DC and  
18       ILECs in other states (for example, California, Illinois, Ohio, Colorado, Georgia,  
19       Connecticut, etc.) have recognized that some indirect or shared costs are avoidable  
20       and likely to be avoided when an ILEC provides retail services to a reseller instead